210198

HARKINS CUNNINGHAM LLP

Attorneys at Law

Paul A. Cunningham
202.973.7601
pac@harkinscunningham.com

Suite 600
801 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-2615

Telephone 202.973.7600
Facsimile 202.973.7610

March 2, 2004

BY HAND

Mr. Vernon A. Williams, Secretary
Surface Transportation Board
Office of the Secretary
1925 K Street, N.W.
Washington, DC 20423-0001

Re: Canadian National Railway Company, *et al.* – Control – Duluth, Missabe and Iron Range Railway Company, *et al.* (STB Finance Docket No. 34424)

Dear Mr. Williams:

Enclosed for filing in the above-captioned proceeding are an original and 20 copies of Applicants' Surrebuttal to Reply Comments of United States Department of Justice and United States Department of Transportation (designated as CN-12). Also enclosed is a diskette containing the text of this pleading in WordPerfect 6/7/8/9/10 format, consistent with 49 C.F.R. § 1104.3(b).

Very truly yours,

Paul A. Cunningham

Enclosures

cc: All Parties of Record

PHILADELPHIA
2800 One Commerce Square
2005 Market Street
Philadelphia, PA 19103-7042
215.851.6700

NEW YORK
One Penn Plaza
25th Floor
New York, NY 10119-2532
212.329.1750

210198

CN-12

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Finance Docket No. 34424

CANADIAN NATIONAL RAILWAY COMPANY,
AND GRAND TRUNK CORPORATION
– CONTROL –
DULUTH, MISSABE AND IRON RANGE RAILWAY COMPANY,
BESSEMER AND LAKE ERIE RAILROAD COMPANY,
AND THE PITTSBURGH & CONNEAUT DOCK COMPANY

APPLICANTS' SURREBUTTAL TO REPLY COMMENTS OF UNITED STATES DEPARTMENT OF JUSTICE AND UNITED STATES DEPARTMENT OF TRANSPORTATION

Sean Finn
CANADIAN NATIONAL RAILWAY COMPANY
P.O. Box 8100
Montréal, PQ H3B 2M9
(514) 399-5430

Theodore K. Kalick
CANADIAN NATIONAL RAILWAY COMPANY
Suite 500, North Building
601 Pennsylvania Ave., N.W.
Washington, D.C. 20004
(202) 347-7840

Paul A. Cunningham
Richard B. Herzog
Gerald P. Norton
James M. Guinivan
HARKINS CUNNINGHAM LLP
801 Pennsylvania Avenue, N.W., Suite 600
Washington, DC 20004-2664
(202) 973-7600

Counsel for Canadian National Railway Company and Grand Trunk Corporation

March 2, 2004

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Finance Docket No. 34424

CANADIAN NATIONAL RAILWAY COMPANY,
AND GRAND TRUNK CORPORATION
– CONTROL –
DULUTH, MISSABE AND IRON RANGE RAILWAY COMPANY,
BESSEMER AND LAKE ERIE RAILROAD COMPANY,
AND THE PITTSBURGH & CONNEAUT DOCK COMPANY

APPLICANTS' SURREBUTTAL TO REPLY COMMENTS OF UNITED STATES DEPARTMENT OF JUSTICE AND UNITED STATES DEPARTMENT OF TRANSPORTATION

CN[1] responds here to the new proposal raised in the Reply of the United States Department of Justice (DOJ-3) and to the Reply Comments of the United States Department of Transportation (DOT-3), filed on February 24, 2004.

I. There Is No Basis for DOJ's Proposed Minntac Condition.

The Board's procedural schedule required all parties to submit any requests for conditions by January 26, 2004. *See* Decision No. 2, at 12, 18. Nevertheless, DOJ has filed what it styled as "reply" comments on February 24, 2004, requesting imposition of a build-in/build-out condition at the United States Steel ("USS") Minntac facility near Mountain Iron, MN on the ground that, according to DOJ, CN "can constrain [DMIR's] market power by threatening to gain access to . . . Minntac . . . through [a] relatively short build-out[] or build-

---

[1] All abbreviations not otherwise identified have the same meanings as those set forth in the Table of Abbreviations found on pp. v-viii of the Application (CN-2).

in[]." DOJ-3 at 5.[2] Since we are otherwise unable under the current schedule to respond on the written record to DOJ's first-time request, CN has requested the Board's permission, in its simultaneously filed motion for leave (CN-11), to file this surrebuttal.

Although the Board had advised parties seeking the imposition of conditions to protect competition that they "must present substantial evidence in support of their positions," Decision No. 2, at 12 (citing *Lamoille Valley R.R. v. ICC*, 711 F.2d 295 (D.C. Cir. 1983)), DOJ submitted no evidence, much less "substantial evidence," to support this assertion. Therefore, DOJ's proposal should be rejected.

It is well established that "potential build-ins and build-outs provide important competitive leverage to solely served shippers in their negotiations with rail carriers." *Canadian Nat'l Ry. – Control – Illinois Cent. Corp.*, STB Finance Docket No. 33556, Decision No. 37, slip op. at 30 (STB served May 25, 1999) ("*CN/IC*"). The Board will therefore impose conditions on a control transaction where necessary "to preserve the competitive advantages made possible by build-outs" and build-ins. *CSX Corp. – Control & Operating Leases/Agreements – Conrail Inc.*, 3 S.T.B. 196, 320 (1996) ("*CSX/NS/Conrail*").

The Board does not, however, simply impose build-in/build-out conditions whenever the mere possibility of a build-in or build-out is asserted, as by DOJ here, on the basis of an examination of a map and a measure of physical distances. Instead, the Board has said that it will impose such a condition "[w]here shippers have provided evidence that they would be losing a particular build-out option," but will not do so where shippers "have not provided any

---

[2] BNSF has requested a generic build-in/build-out condition, without identifying any particular location. BNSF-2 at 6. In its rebuttal, CN identified Minntac as the likely target of BNSF's request, CN-7 at 13-16, and DOJ's reply, along with BNSF's summary of points for oral argument (BNSF-4 at 2-3), confirms CN's assessment.

particular evidence or other basis to support their requested . . . conditions." *Id.* at 260. As the Board noted in the *CN/IC* control proceeding, it will typically craft a build-in/build-out condition based only on competitive impacts "indicated by the record." *Canadian Nat'l Ry. – Control – Illinois Cent. Corp.*, STB Finance Docket No. 33556, Decision No. 39, slip op. at 6 (STB served Aug. 27, 2002) ("*CN/IC Decision 39*").[3]

Thus, for example, in the BN/Santa Fe merger case, the ICC imposed build-in/build-out conditions where the shipper made a record showing that it had "successfully used the threat of a build-out to negotiate its present contract" with one merging railroad, and that another shipper and the potential build-out railroad showed that they had conducted a feasibility study that, according to the shipper, indicated that the build-out was feasible. *Burlington N. Inc. – Control & Merger -- Santa Fe Pac .Corp.*, 10 I.C.C.2d 661, 705-07 & n.50 (1995), *aff'd sub nom. Western Resources, Inc. v. STB*, 109 F.3d 782 (D.C. Cir. 1997). And, in *CSX/NS/Conrail*, which DOJ cites in support of its proposed Minntac condition (DOJ-3 at 5), the shipper, Indianapolis Power & Light Company ("IP&L"), submitted evidence indicating that rates charged by CSX and Indiana Rail Road Company for service to IP&L's Stout power plant had been constrained by "the threat to build out to nearby Conrail lines." 3 S.T.B. at 319. On the basis of that shipper evidence, the Board found that the build-out "appears feasible," and

---

[3] As BNSF does explicitly, DOJ appears to fall back on *Union Pac. Corp. – Control & Merger – Southern Pac. Transp. Co.*, 1 S.T.B. 233 (1996) ("*UP/SP*"), as signaling the Board's preference for imposing generic build-in/build-out merger conditions (without probative evidence of feasibility). DOJ-3 at 5. But as we explained on rebuttal, the Board confirmed in the Conrail proceeding, and consistently since then, that the generic build-in/build-out condition imposed in *UP/SP* was limited to the peculiar facts of that merger, none of which are present here. CN-7 at 11-12 (citing *CSX/NS/Conrail*, 3 S.T.B. at 260; *CN/IC Decision 39*, at 7).

accordingly imposed a build-out condition to preserve IP&L's competitive options. *Id.* at 319-20 & n.180.

This approach is consistent with the balance that the Board has always pursued in order to avoid the risk of unjustified conditions that, without foundation, could undermine significant industry investment decisions otherwise consistent with the public interest. Thus, longstanding Board policy, consistent with the governing statute in this proceeding, has been to provide remedies to protect only those circumstances where competition has been demonstrated to have been substantially lessened.

DOJ, however, has presented no evidence that (1) the prospect of a CN build-in at Minntac has constrained the prices DMIR has charged USS at that location, (2) that CN would be likely to provide a future constraint on DMIR through a build-in or build-out at Minntac if it did not acquire DMIR, or (3) that there otherwise would be a "substantial lessening" of competition at Minntac that would require or justify a build-in/build-out condition. Mere straight-line proximity, as determined by examining a map, is not, contrary to DOJ's assertion (DOJ-3 at 5), sufficient evidence to support such relief.[4]

DOJ's requested relief at Minntac fails not only for want of evidence but because the only evidence available contradicts DOJ's claims. As explained further in the Supplemental Verified Statement of Christopher A. Vellturo, Ph. D. ("Vellturo S.V.S."), there are good reasons to conclude that CN provides neither perceived potential competition nor actual potential

---

[4] The Board made this clear when it considered the joint petition of ATOFINA Petrochemicals, Inc. ("ATOFINA") and KCS to modify the final decision in *CN/IC* to grant build-in relief to ATOFINA. At that time, it observed that a plant three to five miles from the competing rail line would not necessarily have obtained build in-build out relief if its owner had requested it. *CN/IC Decision 39*, slip op. at 6.

competition with DMIR at Minntac, and that the proposed Transaction would result in *no* loss of competition (much less a "substantial lessening of competition") First, if CN offered perceived potential competition, then it would be reasonable to expect USS to take care to preserve the competitive restraint provided by the possibility of a CN build-in or build-out. Yet on at least two occasions when USS could have done so – negotiation of its current Transportation Services Agreement with GLT in 1998, and amendment of that Agreement and the divestiture of USS's remaining interest in DMIR to Blackstone in 2000-2001 – it failed to do so. To the contrary, it agreed that for five years after that divestiture, it would not object to the sale by Blackstone of DMIR to CN or any other entity, other than BNSF. It should therefore be concluded that if any railroad provides perceived potential competition to DMIR at Minntac, it is BNSF, not CN.[5]

Further, as detailed in CN's Rebuttal and in Dr. Vellturo's Supplemental Verified Statement. there are also substantial reasons to believe that CN is not likely, in a timely manner. to provide sufficient competition in the future to warrant a remedy here.[6] The build-in route that DOJ believes possible from CN's line near Minorca Junction would have to overcome physical obstacles that would make new rail construction difficult and costly, if feasible at all. And, CN would have to seek time-consuming and problematic approval to construct the new line.

Finally CN could not obtain a commitment from USS to cooperate with a build-in or to provide any taconite traffic until at least 2009 and any planning, negotiations, permitting

---

[5] BNSF, unlike CN, would have a single-line route to its own ore dock on Lake Superior, and would thus not have to agree to a division of revenue with any other railroad. For traffic moving south past Duluth/Superior, BNSF could use its own line, not subject to trackage rights restrictions such as the Spirit Lake Restrictions that impede CN. *See* CN-7 at 14-15. Moreover, BNSF could build in to Minntac over an abandoned line between Emmert and Mountain Iron that is already graded and that leads to the Minntac mine tracks. CN-7 at 13; Vellturo S.V.S. at 12.

[6] CN-7 at 15-16; Vellturo S.V.S. at 8-10.

(including STB environmental review), and construction would, if at all plausible, likely take years thereafter. Even then, CN's Spirit Lake Agreement would prohibit CN from transporting any Minntac-origin taconite over the DMIR line south of Nopeming Junction, requiring CN to interchange that taconite with BNSF in or around Virginia.[7] In CN's view, these impediments were so substantial that it never undertook even a feasibility study regarding a potential build-in or build-out at Minntac and, as Dr. Vellturo has concluded, they entirely preclude any reasonable finding of actual potential competition.

DOJ has provided no basis for its proposed Minntac build-in/build-out condition. Accordingly, the Board should therefore decline to exercise its conditioning power as requested by DOJ.

II. The Board Should Reject DOT's Proposals Relating To Treatment Of The Ispat Complaint And CN's Settlement With Cleveland-Cliffs.

DOT also submitted two new proposals in its "reply" comments, suggesting that the issues raised by Ispat under a contract between Ispat and CN, which Ispat seeks to leverage into new rights under a contract between Ispat and DMIR, are properly the subject of the *CN/WC* merger proceeding rather than this proceeding. While CN agrees with DOT that the contract dispute at issue is not properly the subject of this proceeding (DOT-3 at 8), and that the Board has required the applicants in *CN/WC* to adhere to the representations they made on the record in that case (*id.* at 9 n.7), CN cannot agree that Ispat's effort to leverage a change in its contract with DMIR is a proper matter for Board review in any proceeding. Ispat has suggested no basis

[7] As we noted previously, even before entering into the Spirit Lake Agreement, CN did not attempt to compete for iron ore traffic from Minntac or any other point in the Mesabi Range. CN-7 at 17-18.

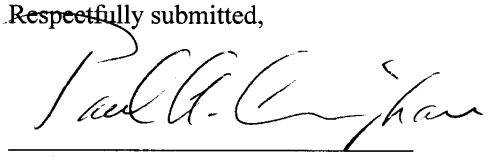
for action by the Board here, and DOT has provided no basis for such action in the *CN/WC* proceeding, especially the relief Ispat seeks concerning its DMIR contract. Accordingly, for these reasons and those explained in CN's rebuttal to Ispat, the Board should reject outright DOT's proposed condition.

DOT also suggests that the Board should review the settlement agreement between CN and Cleveland-Cliffs, Inc. ("Cliffs"). Yet it provides no basis for such review, and, for several reasons, none should be made. First, CN and Cliffs have not asked that the settlement be made a condition of the Transaction. Thus, the settlement is not a subject of this proceeding. Second, given that the Board's principal task here is to protect competition and there is no shipper or other consumer raising competition issues, there is no need for concern that the settlement will have an adverse impact on competition. Finally, because the settlement will not be approved by the Board as a part of the Transaction, no antitrust immunity will be conferred on the settlement under 49 U.S.C. § 11321(a). Thus, any possibility that that the settlement might pose future competitive concerns can be addressed, if that possibility is realized, both under any applicable provisions of the ICC Termination Act of 1995 and under any applicable provisions of the antitrust laws.

CONCLUSION

For the reasons set forth above, the Board should deny the Minntac condition requested by DOJ and should reject DOT's proposals regarding treatment of Ispat's service complaint and the CN settlement with Cliffs.

Respectfully submitted,



Sean Finn
CANADIAN NATIONAL RAILWAY COMPANY
P.O. Box 8100
Montréal, PQ H3B 2M9
(514) 399-5430

Theodore K. Kalick
CANADIAN NATIONAL RAILWAY COMPANY
Suite 500, North Building
601 Pennsylvania Ave., N.W.
Washington, D.C. 20004
(202) 347-7840

Paul A. Cunningham
Richard B. Herzog
Gerald P. Norton
James M. Guinivan
HARKINS CUNNINGHAM LLP
801 Pennsylvania Avenue, N.W., Suite 600
Washington, DC 20004-2664
(202) 973-7600

Counsel for Canadian National Railway Company and Grand Trunk Corporation

March 2, 2004

CERTIFICATE OF SERVICE

I hereby certify that I have this 2d day of March, 2004, served the foregoing Applicants' Surrebuttal to Reply Comments of United States Department of Justice and United States Department of Transportation (CN-12), including the attached Supplemental Verified Statement of Christopher A. Vellturo, Ph.D., on all parties of record in this proceeding by first-class mail or a more expeditious method of delivery.

Sarah K. Watson

BEFORE THE SURFACE TRANSPORTATION BOARD

Finance Docket No. 34424

Canadian National Railway Company
and Grand Trunk Corporation
--- CONTROL---
Duluth, Missabe and Iron Range Railway Company,
Bessemer and Lake Erie Railroad Company,
and The Pittsburgh & Conneaut Dock Company

SUPPLEMENTAL VERIFIED STATEMENT
OF
CHRISTOPHER A. VELLTURO, PH.D.

I. Assignment and Conclusions

I am the founder and president of Quantitative Economic Solutions, LLC, a microeconomic consulting firm located in Cambridge, Massachusetts. I previously submitted a statement in this proceeding to address certain competitive ramifications of Canadian National Railway's ("CN") proposed acquisition of the freight railroad subsidiaries of Great Lakes Transportation LLC ("GLT"). Since that time, I have become aware that the United States Department of Justice Antitrust Division ("DOJ") has submitted a Reply to the Surface Transportation Board ("DOJ Reply") relating to certain potential competition issues raised by the above-identified transaction.[1] I submit this supplemental statement to consider and analyze the potential competition issues raised in the DOJ Reply.

[1] "Reply of the United States Department of Justice", filed February 24, 2004.

The DOJ Reply identifies two mines in the Mesabi iron range of Minnesota where DMIR currently provides the only rail service for the movement of taconite pellets out of the mine: 1) the recently re-opened EVTAC processing plant in Fairlane, MN[2]; and 2) the Minntac mine/pelletization facility near Mountain Iron, MN. At the Fairlane facility, the DOJ has concluded that CN represents the most likely railroad to offer a build-in opportunity to the mine/plant (as CN's track currently terminates about 500 feet from the pelletization facility served by DMIR), and that the proposed transaction should be approved only with conditions that ensure that a third-party railroad is provided with build-in access sufficient to replace the potential access offered by CN. I understand (as noted in my original statement) that CN is prepared to offer such access as part of the approval process of this transaction.

The DOJ Reply also concludes that CN "might" be able to provide joint line service with the BNSF to the Minntac mine were CN to construct a 4-5 mile build-out from CN's main line near Minorca Junction, MN, into the Minntac facility. The DOJ concludes that "this appears to be a possible two-to-one" competitive situation; or if one considers a potential build-out opportunity available to BNSF to Minntac, "a possible three-to-two" competitive situation. In any event, the concern at issue is whether the loss of such purported potential competition gives rise to sufficient concern to merit the imposition of additional conditions on the proposed transaction. The DOJ concludes that only CN can constrain the market power currently possessed by DMIR at Minntac, and that CN constrains this power through its ability to gain access to Minntac through a relatively short build-in (DOJ Reply, p. 5). Therefore, the DOJ Reply concludes, additional conditions should be imposed on the proposed transaction to maintain this purported competitive threat.

[2] The DOJ Reply also considers potential competition issues that arise at the EVTAC Thunderbird mine, which provides raw iron ore to the Fairlane facility for pelletization. The potential competition issues/remedies in place with respect to these two facilities are sufficiently similar that I did not distinguish them in this statement.

In this supplemental statement, I assess the validity of this "potential competition" claim in the DOJ Reply with respect to the Minntac facility. As is often the case in an analysis of potential competition, a careful assessment of the timeliness, likelihood and sufficiency of the entry that constitutes the hypothesized potential competition is essential in determining the likely competitive effects of a transaction. I apply this "timely, likely, and sufficient" ("TLS") standard (discussed more fully, below) to the Minntac issue in this transaction.

I find that the suggested CN competition at Minntac does not meet the TLS standard. The suggested competitive threat offered by CN into Minntac is unlikely to occur, if at all, in a timely or sufficient fashion, and no enforcement of regulatory action is warranted with respect to the Minntac facility. In part, I reach this conclusion based on several points, including the following:

- There is no evidence that CN's potential entry has served or does serve as a meaningful constraint on the pricing decisions of DMIR, the current provider of rail service at Minntac.
- There is no evidence that CN's potential entry at Minntac has ever been considered by CN at all or that U.S. Steel ever contemplated that CN was a potential pricing constraint on DMIR at Minntac.
- Cooperation from U.S. Steel (the owner of the Minntac facility) with respect to any purported build-out is contractually prohibited until mid-2008; and, as a practical matter, no entry possibilities can likely be explored until 2009 at the earliest.
- The 4-5 mile hypothetical build-in routes from CN's main line to Minntac are fraught with practical problems, including sharp elevation gradients, the need to secure a right of way, and the presence of a National Forest, a deep mine pit, and local population centers.
- The alternative potential BNSF route to the Minntac facility would be along a route where much of a former railroad right of way (remaining from an abandoned BNSF line) exists; thus the effective *de novo* build-in requirements for BNSF appear to be less imposing than those available for CN.
- CN has no independent access to competitive iron ore ports along Lake Superior; thus, CN would be wholly dependent on moves where BNSF would provide the bulk of the freight service to reach any Lake Superior terminal.

I provide a more complete analysis below. First, I identify the two types of antitrust issues that can arise with respect to potential competition in a merger setting, namely "perceived" potential competition ("PPC"), and "actual" potential competition ("APC"). I use this terminology because it is the terminology that is used in the 1984 DOJ Merger Guidelines.[3] Note, however, that this terminology can be somewhat confusing, in that PPC denotes potential competition that is currently a substantial restraint on prices, while APC denotes potential competition that is not having a current effect but can be reasonably expected to have a substantial restraining effect in the future.

Then I find that there is no evidence that CN provides PPC at Minntac. I then analyze issues relating to CN as a provider of APC and determine that CN is not an expected potential competitor in the foreseeable future, and to the extent it might be considered to be able to do so, it is a far less likely candidate to provide APC than BNSF.

Finally, I show that, given that CN is a significantly less likely entrant at Minntac in the future than BNSF, it is incorrect as a matter of economics to treat BNSF and CN as potential entrants with equal weight, such as is implied by DOJ's suggestion that the transaction poses a reduction in market participants from "three-to-two."

II. Potential Competition Analysis

From an economic standpoint, harm to competition can stem from the removal of potential competition where such potential competition provides a current constraint on pricing in a market (PPC) or where potential competition will likely enter the market at some time in the future, at which time prices will be lower as result of the competition provided by the new

[3] 1984 Merger Guidelines, 49 Fed. Reg. 26,823, 4 Trade Reg. Rep. ¶ 13,103 at §§ 4.111, 4.112 (June 14, 1984). While the Department of Justice and the Federal Trade Commission have issued new Horizontal Merger Guidelines in 1992 (revised in 1997), the 1992 Guidelines "do not include a discussion of horizontal effects from non-horizontal mergers (e.g., elimination of specific potential entrants [such as CN is alleged to be here] and competitive problems from vertical mergers)." 1992 Horizontal Merger Guidelines, 57 Fed. Reg. 41,552, 4 Trade Reg. Rep. ¶ 13,104, Statement Accompanying Release of Revised Merger Guidelines (Apr. 2, 1992). For those matters, the 1984 Merger Guidelines continue to reflect the policies of DOJ and FTC. *Id.*

entrant (APC). Facing PPC, an incumbent market participant today is unable to raise its price above current levels, because such an increase would render entry profitable and result in significant losses of business to the incumbent. The current equilibrium price is just such that entry is unprofitable. The removal of such PPC (*e.g.*, through a merger) would remove this constraint, and enable the incumbent to raise its prices immediately. Thus the competition is "potential" because the competitor is not currently serving the market, but the effect is "perceived" because the potential entry is keeping prices lower than otherwise would be the case today.

A potential entrant providing only APC is not currently constraining the price of any incumbent. However, it is likely that the potential entry will occur at some reasonably foreseeable date, and at that time, the entrant will enter the market with a sufficient presence to create downward pressure on price. In this instance, a merger that would eliminate the potential entrant would have no adverse impact on current prices, but, by foreclosing the likelihood that an entrant would enter in the future, might have an adverse impact on prices that might prevail in the future.

In my 20 years of merger and acquisition experience, I have evaluated numerous transactions that have involved the consideration of such potential competition issues. Typically, potential competition issues involve the entry (or threat of entry) by one of the merging parties into a line of commerce served by the other merging party. Thus, the standards of analysis utilized by the enforcement agencies to assess the timeliness, likelihood, and sufficiency of such potential entry are critical to the determination of whether such potential competition represents a current constraint of pricing, or may present a constraint at some point in the reasonable future.[4] As with other transactions in which such issues have arisen, I apply the

[4] 1992 Horizontal Merger Guidelines, § 3.0.

"timely, likely, sufficient" standard in my consideration of the competitive consequences of the CN-GLT transaction at the Minntac facility.

III. Evaluation of Whether CN Provides Perceived Potential Competition at Minntac

A key question is whether a potential build-in by CN from its main line into the Minntac facility provides perceived potential competition to DMIR for the movement of taconite pellets out of Minntac. If so, then there should be evidence that U.S. Steel, the sole customer, sees CN as a credible alternative carrier and uses CN as a threat against DMIR to keep down the prices U.S. Steel pays DMIR for taconite rail service. Similarly, there should be evidence that DMIR perceives the CN build-in as a threat that currently "limits" how much DMIR can charge U.S. Steel for these movements. No evidence, however, has been proffered that CN has ever presented such a threat, and, to the extent there is any evidence that U.S. Steel perceived an alternative railroad and a related build-in as a threat against DMIR (or perceived an alternative railroad to potentially provide such a threat), that railroad has been the BNSF, not CN. Thus, while BNSF may provide PPC at Minntac, there has been no showing that CN has at any time provided PPC at Minntac.

There is no evidence in the record that U.S. Steel ever considered a build-in opportunity by CN as a credible threat to use in its pricing negotiations with DMIR. By contrast, I am aware of evidence that another taconite mine has used the threat of a CN build-in opportunity to effectively discipline incumbent pricing. EVTAC is said to have used CN to provide such a credible threat in its negotiations with DMIR in the late 1990s. In that instance, CN undertook feasibility plans and volume forecasts to EVTAC for the proposed build-in and EVTAC purportedly used these plans as a threat to obtain more attractive pricing from DMIR even though there were potentially insuperable contractual/regulatory barriers to a competitively

effective build-in. *See also, e.g., Burlington N. Inc. – Control & Merger – Santa Fe Pac. Corp.*, 10 I.C.C.2d 661, 705-06, 744-45 (1995) (record showed that prospect of build-out had been used as leverage in rate negotiations).

If CN represented a similar, credible build-in threat at Minntac, I would expect to see similar activity surrounding such a build-in, with U.S. Steel seeking to explore and develop this threat against DMIR. But during recent negotiations with Blackstone in 2000 and 2001, which led to U.S. Steel's sale to Blackstone of its remaining interest in DMIR, U.S. Steel took no steps to preserve a hypothetical build-in opportunity from CN, and did not seek any feasibility studies or plans from CN for its movement of taconite out of Minntac. Nor did CN view such an opportunity as credible at that or any other time, as it made no attempts to undertake initial feasibility studies or conversations with U.S. Steel.

The only evidence I have seen that indicates that U.S. Steel perceived a build-in by another railroad as an important threat to maintain against DMIR at Minntac identifies BNSF, not CN, as the likely entrant. This is not surprising, as, for reasons I elaborate upon below, the evidence suggests that BNSF represents a much more likely candidate to provide new service to Minntac (from its line at Emmert, MN) than CN. When U.S. Steel sold its remaining interest in the DMIR in 2001, U.S. Steel retained the rights to challenge an acquisition of DMIR by BNSF. U.S. Steel did not retain such rights with respect to an acquisition of DMIR by CN, or by any other railroad. This conduct indicates that U.S. Steel perceived that a BNSF acquisition, which would have cut off forever the possibility of a BNSF build-in at Minntac, could result in significant harm in the form of reduced competition and higher prices for transport out of Minntac, but that a CN acquisition posed no such threat.

IV. Evaluation of Whether CN Provides Actual Potential Competition at Minntac

I have also examined whether CN provides meaningful actual potential competition at Minntac When I look for APC, I seek to determine whether CN entry into the provision of transportation services for taconite out of Minntac would be timely, likely and a sufficient competitive alternative to have a meaningful incremental impact on the pricing of taconite shipments out of Minntac. I find that such entry by CN is not timely, likely or sufficient and thus CN does not represent a meaningful competitive threat at Minntac in the foreseeable future.

A. Timeliness

Under an assessment of timeliness, I consider whether the proposed entry could take place in a reasonably short time frame, so that the potential competitive impact of such entry would not take place sufficiently far in the future so as to render the entire proposed competitive analysis unduly speculative. DOJ offers no evidence to support a finding that such a construction would be timely. Based on the evidence of record and my knowledge of regulatory proceedings in cases in this industry involving generally comparable impediments,[5] I find it highly unlikely that CN entry could occur (if it were to occur) before 2015.

---

[5] In *Tongue River R.R. Co. – Rail Construction and Operation – Ashland to Decker, Mont.*, STB Finance Docket No. 30186 (Sub-No. 2) (STB served Nov. 8, 1996), for example, the environmental review process took nearly four years to complete where the alternative routes under evaluation raised the prospect of environmental impacts that included deforestation, land disturbance, safety risks and air pollution associated with steep gradients, residential proximity, and disruption of an environmentally sensitive river canyon. Slip op. at 7-14. The STB ultimately approved construction along one of the two routes, subject to environmental conditions, in November 1996, more than five years after Tongue River Railroad Company ("TRRC") had filed its petition (in June 1991). *Id.* at 3-4. Based on TRRC's estimate of the time needed to complete all of the activities leading up to construction – including design and engineering studies, permitting processes, project financing, and the purchase of necessary right-of-way – as well as the bidding process and construction itself – the STB imposed a condition that construction be completed within three years. *See id.* at 23 n.30 & 25. However, the condition was later removed when the Board found that, despite TRRC's diligence in moving the project forward, construction could not be completed within three years. *Tongue River R.R. Co. – Rail Construction and Operation – Ashland to Decker, Mont.*, STB Finance Docket No. 30186 (Sub-No. 2) (STB served Mar. 30, 1999).

It is not uncommon for the environmental review process in a build-in proceeding to take several years. In *Kansas City S. Ry. – Construction and Operation Exemption – Geismar Indus. Area*, STB Finance Docket 32530 ("Geismar") (STB served Aug. 28, 1998), KSC's petition for an exemption from prior approval to construct a build-in at Geismar was filed in February 1995 but the environmental review process remained incomplete some three years later, when on August 28, 1998 the STB ordered the petition to be held in abeyance pending the outcome of the *CN/IC* control proceeding (which marked the final result with respect to the Geismar build-in).

I understand that the CN build-in would require an addition of at least four to five miles of new track over very difficult terrain from CN's main line to the Minntac taconite facility. Any consideration of such a significant build-in would require the cooperation and input of the potential customer, here U.S. Steel, in evaluating, costing and developing any available build-in options.[6] Yet, under terms of its transportation services agreement with DMIR, U.S Steel has agreed not to solicit or cooperate with any effort by a competing carrier to build-in to Minntac until June 30, 2008.[7] After June 2008, U.S. Steel may cooperate with any such build-in only after securing such a right through mediation/arbitration with the DMIR.

Thus, CN could not even begin the planning process for a build-in to Minntac until after the completion of a mediation/arbitration that would commence in mid-2008 and could readily extend into 2009 or beyond. Beyond the date that the mediation or arbitration was resolved, planning the route and construction, negotiating a transportation services agreement, and the permitting and construction processes would need to be undertaken before service could commence. I understand that the planning and agreement stages, which were never completed, for the relatively short and uncomplicated proposed EVTAC build-in took place over a period of more than two years. The permitting process was expected to take at least one year. And the EVTAC build-in was expected to take over a year from initial plan to completion.

We could expect any Minntac construction to take much longer. The most direct route from CN to Minntac's loading facilities (other than one through the eastern Minntac mine pit, which CN informs me would be virtually impossible to construct), would traverse portions of the Superior National Forest. I understand from the Forest Service that the construction of a linear

[6] Again, the EVTAC exercise is instructive here, as CN individuals worked closely with EVTAC officials in developing plans for a potential build-in at EVTAC.

[7] *See* Transportation Services Agreement, sections 2, 3 (July 1, 1998) and Amendment of Transportation Services Agreement, sections 2-4 (Mar. 23, 2001) (both reprinted in CN-7, Exhibit C).

right of way, such as that required by a freight railroad moving unit trains heavily laden with iron ore, would be subjected to a "difficult and time consuming regulatory process." An initial proposal to the District Manager of the forest would require approval. Once approved, the parties would be eligible to submit an application to the Regional Forest Service Office, which would review the proposed plans and specifications for environmental soundness. If approved, the parties would receive a Special Issues Permit. I understand such permits are rarely approved.[8] The alternative route, south of the eastern Minntac mine pit, would face alternative routing, property acquisition and permitting obstacles. In any event, the construction would require approval and environmental review by the Surface Transportation Board, a process that, as noted above, can be quite protracted and take several years. CN does not believe that it could overcome these obstacles in less than three years after reaching an agreement with U.S. Steel that would warrant undertaking the effort.

Thus, if we assume that all would go very well for CN and U.S. Steel, it would likely take U.S. Steel at least until mid-2009 to secure the right to encourage a build-in, another year to negotiate an agreement with CN, one to two years to complete design studies, acquire the necessary permits, and make the land acquisition, and at least three years to complete environmental review and obtain STB approval. CN informs me that construction itself would likely require an additional eighteen months to two years. All of these considerations would place CN in a position to meaningfully compete for Minntac business no earlier than 2015; this means that potential competitive harm could only manifest itself, at the earliest, some eleven years after the date of the proposed transaction.

[8] In the past few years, a 6-7 mile power line was constructed within the forest; the permitting process for that construction took more than two years. Conversations with Superior Forest Supervisor's Office, February 24, 2004.

B. Likelihood

Is the CN build-in likely? That is, given the likely industry dynamics, build-in costs and competitive environment, will CN find such an investment to offer a competitive rate of return given the risks inherent in such a venture? The available evidence strongly indicates that CN entry is unlikely, and critically, that CN entry is significantly less likely than entry by BNSF.

At present, no feasibility plans or studies concerning a build-in from CN's main line to Minntac exist, nor were any under consideration at the time the proposed acquisition was undertaken. I see no basis under which a build-in opportunity that was never realistically considered by CN (or U.S. Steel) will not only be considered, but will be approved and completed, in the near future. Moreover, I have no reason to believe that demand for taconite will be any greater in the future than it is today. Thus, I see no economic evidence why a build-in that has never been on CN's or U.S. Steel's radar screen historically will suddenly represent an attractive profit opportunity in the foreseeable future.

Leaving this observation aside, absent the existence of any historic planning or feasibility studies, all such initial work would need to be undertaken from scratch. The significant logistical issues noted above make it even less likely that, based on a risk-adjusted assessment, the proposed build-in will ever be recommended or undertaken.

Moreover, CN does not have independent access to a critical input required to successfully move taconite out of the Mesabi range and off to various blast furnaces located throughout North America – access to competitive ports along Lake Superior. Absent such access, CN must turn to an alternative route involving interlining traffic to BNSF for delivery to BNSF's ore docks at Lake Superior. I find that such an arrangement is unlikely to provide an economically reasonable return to CN for its investment.

As I will demonstrate below, BNSF appears to have the more attractive build-in opportunity to Minntac. Thus, should market conditions arise to capture CN's interest, such conditions would also capture BNSF's interest, and likely lead them to execute a build-in where they would control access to the mine *and* access to Lake Superior. Absent access to Lake Superior, CN has no realistic routes over which to complete its taconite shipments. Recognizing this issue, it is likely that BNSF would be able to extract the bulk of the significant economic profits (ex ante[9]) associated with a build-in to Minntac, making the likelihood that such a build-in would generate a sufficient rate of return at CN even more remote.

Finally, as noted through this statement, the evidence I have reviewed shows that BNSF offers a more likely build-in candidate than CN to Minntac. The DOJ reply bases its conclusion that CN is the more likely build-in candidate into Minntac on a single statistic, that it is four to five miles from the CN main line to Minntac, while it is 15 miles from the currently active BNSF main line to Minntac.[10] CN has informed me that the route from BNSF's track at Emmert to a connection with the Minntac mine tracks at Mountain Iron, which may be shorter than DOJ has suggested, is already graded, as a currently abandoned rail line once passed along this route. If this route were reestablished, BNSF would control *both* of the key elements of a successful taconite haul; access to the mine, and access to Lake Superior. Given this relative ease of entry for BNSF, it is not surprising from an economic standpoint that U.S. Steel only retained its rights to oppose a transaction in which BNSF would acquire DMIR.

Critically, the relative attractiveness of BNSF's entry compared to CN implies that, should conditions warrant a build-in to Minntac, CN would not expect to be the only railroad to

---

[9] This would occur ex ante because CN would want to know *before* undertaking to build what its revenue division on the CN-BNSF interline movement would be, as this information would bear directly on whether the build-in represented an attractive profit opportunity for CN.

[10] DOJ Reply, p. 6

undertake or explore such opportunities. This competition from BNSF would either drive down the price that CN would need to offer in its negotiations with U.S. Steel to secure the build-in rights, or result in lower prices and reduced volumes should both entities execute build-ins. In either event, the presence of a superior build-in by BNSF would render even more remote the likelihood that CN, too, would build in.

C. Sufficiency

The DOJ Reply suggests that both BNSF and CN may have build-in opportunities to the Minntac taconite plant, and that the proposed transaction may be thus be assumed to result in a "three-to-two" change in competitive structure at this facility. As a matter of economics, this characterization does not make sense. Typically in mergers generally (and very commonly in rail mergers), a three-to-two analysis is based on the assumption that each of the industry participants is more or less equally situated with respect to the services at issue. This assumption does not apply in the current instance. First, the incumbent, DMIR, is a much stronger competitive participant than the other two potential competitors. If it perceived potential entry, it might be expected to "limit price," that is, lower its prices just enough to make entry economically unattractive and thus continue to serve the market entirely itself, enjoying full economies of scale and scope. Other entrants may have to share the market with the incumbent, thereby generating more limited economies. Second, if there is in fact a potential competitor with DMIR at Minntac, it is more likely to be BNSF than CN, if only because BNSF has unilateral access to Lake Superior, while CN must rely on its access through a third party (importantly, BNSF).

Taken in this context, characterizing CN, in the context of the "3-to-2" paradigm, as suggested by the DOJ Reply, as an equivalent participant with respect to the services at issue to DMIR and BNSF, would be erroneous and lead to a misguided sense of CN's true competitive

significance. CN is by far the weakest potential competitor of the three, and is highly unlikely to generate any meaningful *incremental* competitive discipline in the relevant marketplace. In this sense, CN's purported entry does not have an incremental effect on competition.

Summary

Based on my economic analysis, I find that the proposed transaction between DMIR and CN will result in no lessening in competition, either through the elimination of perceived potential competition or actual potential competition. As a result, no remedial action with respect to the Minntac facility is warranted.

VERIFICATION

I, Christopher A. Vellturo, verify under penalty of perjury under the laws of the United States that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this Verified Statement.

Executed on March 2, 2004

Christopher A. Vellturo